Real Estate Finance

Student's Course Outline

For use in the 30-hour course
designed by the
Idaho Real Estate Education Council

February 23, 2001

Standard Course Materials:

- Current printing of *Essentials of Real Estate Finance*, by Sirota
- Current printing of *Realty Bluebook*, and accompanying financial tables
- Financial calculator

<u>Students MUST be familiar with the financial functions of their calculator!</u>

Table of Contents

■ ***REALTY BLUEBOOK***

A. Finance

B. Tax Information

C. Risk Management

D. Sales Techniques

1. Listing Techniques

2. Sales Techniques

E. Checklists

■ ***REALTY BLUEBOOK* (FINANCIAL TABLES)**

A. Tables

1. Amortization Tables (see Worksheet A)

2. Remaining Balance Tables (see Worksheet B)

3. Yield Tables (see Worksheet C)

4. Future Value Tables (see Worksheet D)

5. Present Value Tables (see Worksheet E)

6. Directions for Use of Tables

B. Introduction to Use of Other Tables

WORKSHEET A

If a commercial borrower, or more likely, a farmer asks you for the annual payment on a loan, would you be inclined to figure the monthly payment and just multiply by 12? We all know the *monthly* payments, but how about the *annual* payment?

Using the monthly payment table for a $100,000 loan at 10%, where the term is 30 years, figure the *monthly* payment:

$________________ / month. Multiply X 12 = $_____________ annually.

Now figure the *annual* payment for a loan of $100,000 at 10% for 30 years.

$________________/ year.

How much is the difference in 12 times the monthly payment -vs- the annual payment?

$__________________

What causes this difference?

Let's do the same thing with our calculators - first figure the monthly payment on the above loan, then the annual payment, and figure the difference between 12 times the monthly compared to the annual payment.

Which is more accurate, the Blue Book or the calculator?

WORKSHEET B

Let's say you are acting as a buyer's agent. The Buyer asks you to write a Purchase and Sale Agreement for a $100,000 purchase price where there is a loan of $60,000 on the property that can be assumed. The buyer has only $20,000, so there will be an equity difference of $20,000 to be made up between the buyer and seller. The buyer asks you to write the offer with terms on the 2nd mortgage of 6% interest, and a 40-year term. The seller counters with 12% interest and a 10-year term. The buyer counters with 8% interest, and a 30-year term. After several trips back and forth, you come up with 9% interest, 30-year amortization, but a 5-year "Balloon" payment. The buyer wants to know what this balloon payment will be, so they can start to plan for it and be able to pay it off in 5 years.

Using the Remaining Balance table, calculate the balance due in 5 years _\$____________________________

Let's use the calculator to figure the same thing:

Using the calculator, calculate the balance due in 5 years _\$____

Which is more accurate, the calculator or the Blue Book?

What causes the difference?

WORKSHEET C

From the problem in Worksheet B, what if the seller of the house has to have all, or nearly all, of his cash at the closing table? You may not have a sale at all if you can't sell the $20,000 note to an investor. The "Yield Tables" will help us to determine the value of the note on the open market.

Using the $20,000 note at 9%, let's see what an investor would pay for the note.

If the investor wanted a yield of just 9%, the sale price would be: $________________________________

However, if the investor wanted a yield of 10%, we have to be able to "discount" the note until we find out what an investor would pay for this 9% note to yield 10%. This is very similar to what happens in the bond market every minute of every day. If you have a $1,000 bond that is paying 10% interest, you will get $100 in interest every year. But if you could pay only the discounted price of $900, the $100 income will equate to 11.11%!

What our investor wants to know is how much to pay for the already fixed income of $160.92 per month, and the remaining balance at the end of 5 years of $19,176.03, because we already know what he would pay if he wanted to earn 9%.

PV at 10% yield = $___________________

What would he pay if he wanted to earn 11%? $_____________________

What about 12%? $_____________________

WORKSHEET D

How much money would you have if you took a single dollar to the bank and deposited it for one year at 10% interest? $_____________________.

How much would you have if you deposited the same $1 and left it for 2 years? $__________. Not too hard, right? But what if you left it for 5 years? Well, the problem gets harder to do, and this is where the Future Value tables come in to their real worth.

Using the "Future Value Tables" (Compounded ANNUALLY), what is the worth of $5,000 deposited for 5 years at 10% interest? $_____________________.

What value do you see shown in the future value tables where the Yrs. (5) row and the "Single Sum" column meet? ___________________. This is the value to which $1 will grow at 10% for 5 years. Since we have $5,000 in our problem, just multiply this factor times 5,000 and you will get: $ _____________________.

Now let's see if we can do the same thing with our calculators? What value do you get with the calculator? $ ____________________.

What is the difference?

Which is more accurate, the calculator, or the Blue Book?

WORKSHEET E

The Present Value Tables are extremely valuable when trying to determine what you have to invest TODAY to receive a future known amount of money. In our study of the future value tables, we theorized that if we took $1 to the bank, they paid us 10%, and we left the money on deposit for a year, we would have $1.10 at the end of the first year. That's really simple, but what if I asked you what you STARTED OFF WITH when you have just $1 at the end of the first year. In other words, how much would you have to deposit (at 10% interest) on January 1, to have $1.00 at the end of the first year? For instance, we know that if you end up with $1.10, you started with $1.

Take a look at the Present Value tables for 10%, and line up where the years (1) column and the "Single Sum" row meet. What number do you see? __________________

This is the amount of money you would have to deposit on January 1 at 10% to have $1 on December 31! (More than $.90, but less than $.91)

Do you suppose we can do this problem on our calculators? You bet we can, and what number do you get? _____________________.

Which is more accurate, the calculator or the Blue Book?

(Set your calculator to the maximum number of decimal places)

Now let's apply this to the problems in the "Pre-Test."

Chapter 1 THE NATURE AND CYCLE OF REAL ESTATE FINANCE

A. The Nature of Real Estate Finance

1. Importance of Construction Industry
   a. Changes in activities
   b. Sources of funds

2. Credit System Economy
   a. Credit cards and charge accounts
   b. Concept of using something while paying for it
   c. Long-term nature of real estate loans
   d. Disintermediation: more funds withdrawn than deposited

3. Financing Relationships
   a. Collateral
   b. Hypothecation
   c. Leverage

B. Mortgage Lending Activities

1. Savings and Mortgage Lending
   a. Concept of savings used for loans producing interest to pay interest on saver's deposits
   b. Financial institutions making real estate loans
   c. Scope of mortgage lending
   d. Price fluctuations depend on market conditions
   e. Interest rates

2. Local Markets
   a. Real estate market fixed in place
   b. Impact from local activities
   c. Higher interest rates and/or unemployment affect on market

3. National Markets
   a. Balance supply and demand on local level
   b. Secondary market participants
   c. Participants purchase loans from local lenders
   d. Stabilizing influence of secondary market

C. Real Estate Cycles

1. Supply and Demand
   a. General business conditions
   b. Supply of money
   c. Market response

2. Population Characteristics
    a. Population makeup
    b. 1999 Census increases
    c. Aging population
    d. Current trends

3. Social Attitudes
    a. Fast growth concessions to induce industry
    b. Attitudes towards smart growth

4. Tax Issues
    a. Tax Reform Act of 1986
    b. Taxpayer Relief Act of 1997

5. Property Value Fluctuations
    a. Property values rise and fall in short run; rise in long run
    b. Stabilizing influence of Fannie Mae, Freddie Mac, and Ginnie Mae
    c. Financial management policies of Federal Reserve and U.S. Treasury

D. Changes in Real Estate Finance

1. Changes from Early 1980s to Present
    a. Interest rates
    b. Inflation rate
    c. Deregulation
    d. Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)

2. Office of Thrift Supervision (OTS)
    a. Control of savings institutions
    b. Shrinkage of thrift industry
    c. Strict underwriting inhibits commercial lending

3. Present Economy
    a. Annual growth projection
    b. Property values

Chapter 2MONEY AND THE MONETARY SYSTEM

A. What Is Money?

1. Definition
    a. Method of exchange
    b. System of money based on confidence

2. Supply and Costs of Money
    a. Supply of money
    b. Cost of money
    c. Balanced economy shaped by federal agencies

B. The Federal Reserve System (FED)

1. Purpose
    a. Established in 1913 as “monetary manager”
    b. Central bank of United States

2. Organization
    a. Central banking system with 12 districts
    b. Responsible to Board of Directors

3. Member Banks
    a. Nationally chartered commercial banks
    b. State chartered banks may become members

C. Instruments of Credit Policy

1. General Functions
    a. Issue currency
    b. Regulate member banks
    c. Clear and collect checks
    d. Administer credit controls
    e. Government’s fiscal agent
    f. Functions related to real estate

2. Reserve Requirements
    a. Protect depositors
    b. Manage national money market
    c. Amount of reserves

3. Discount Rates
    a. Commercial paper
    b. Discount window
    c. Discount rate
    d. Prime rate
    e. Effect of raising or lowering discount rate
    f. Federal Funds Rate

4. Open-Market Operations
    a. Purchase or sale of government securities
    b. “Over the counter” transactions
    c. Federal Open-Market Committee

5. Truth-in-Lending Act (TILA)
    a. Title I of Consumer Protection Act of 1968
    b. Regulation Z
    c. Covered by TILA
    d. Annual percentage rate (APR)
    e. Regulation Z disclosures
    f. Advertising requirements

    g. Right of rescission

D. The United States Treasury

1. Nation’s Fiscal Manager
    a. Collects fund for operation expenses
    b. Borrows money to offset shortages
    c. Issues and sells short- and long-term securities

2. Role of the Treasury
    a. Issuing and repaying securities affect on flow of money
    b. Possible conflict with Fed goals
    c. Supplier of funds for federal agencies

3. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)
    a. Purpose
    b. Federal Deposit Insurance Corporation moved from Fed to Treasury Department
    c. Title I, Section 101 of FIRREA stated purposes

4. Federal Deposit Insurance Corporation (FDIC)
    a. Created by Banking Act of 1933 to reinstate public confidence
    b. Insures accounts in member institutions
    c. Administered by board of governors
    d. Supervises member banks and thrifts
    e. Appoints receiver or conservator for failed banks or thrifts

5. Deposit Insurance Fund (DIF)
    a. Eliminated Federal Savings and Loan Insurance Corporation (FSLIC)
    b. Bank Insurance Fund (BIF)
    c. Savings Association Insurance Fund (SAIF)

E. Federal Home Loan Bank System (FHLB)

1. Organization
    a. Patterned after Federal Reserve System
    b. Office of Thrift Supervision

2. Activities
    a. National market for member securities
    b. Source of funds for members
    c. Current comeback in financing market

Chapter 3 ADDITIONAL GOVERNMENT ACTIVITIES

A. U.S. Department of Housing and Urban Development (HUD)

1. Creation and Purpose
    a. National Housing Act of 1934
    b. Cabinet status in 1965

c. Responsible for policy and programs addressing housing needs
d. Primary activities
e. HUD 2020 and Community Builders

2. Interstate Land Sales Full Disclosure Act of 1968
   a. Criteria for marketing residential land of 25 or more lots through interstate commerce
   b. Exceptions
   c. Requirements

3. Community Activities
   a. Urban renewal
   b. Public housing
   c. Community Development Block Grants (CDBG)
   d. Subsidized housing/Section 8 Certificates and Vouchers
   e. Public housing

B. Other Federal Legislation

1. Federal Equal Credit Opportunity Act (ECOA)
   a. Title VII of Consumer Protection Act
   b. Basic provisions prohibit lender from discriminating based on:
   c. Justice Department and HUD charged with protecting borrowers from discrimination in lending practices under fair housing and ECOA

2. Real Estate Settlement Procedures Act (RESPA)
   a. Protection for participants in residential real estate transactions
   b. Required disclosures
   c. Prohibition against kickbacks

3. Community Reinvestment Act (CRA)
   a. Responsibility of financial institution to meet credit needs of the community served
   b. Federal supervisory agencies
   c. Compliance with CRA
   d. Affordable housing and financing programs

4. Home Mortgage Disclosure Act (HMDA)

C. State Financing Agencies

1. Industrial Development Agencies
   a. Industrial revenue bonds (IRBs)
   b. Community growth

2. Mortgage Insurance Programs
   a. General obligation or revenue bonds
   b. Special loans for purchase of farm or ranch land

3. Community Redevelopment Agencies

a. Expansion of low-income housing
b. Tax increment financing
c. Mortgage revenue bonds

D. Agricultural Lending

1. Cyclical requirements for farm loans

2. Farm Credit System (FCS)
   a. Provides credit for farmers, ranchers, cooperatives, rural homeowners, electric and telephone cooperatives, and rural water systems
   b. Main participants
   c. Farm Credit System Insurance Corporation (FCSIC)

3. U.S. Department of Agriculture Rural Development Program
   a. Combines Farmers Home Administration, Rural Development Administration, Rural Electrification Administration, and Agricultural Cooperative Service
   b. Partnerships with rural communities

4. Farm Credit Council

Chapter 4THE SECONDARY MORTGAGE MARKET

A. Federal National Mortgage Association (Fannie Mae)

1. Origination
   a. Created as government agency in 1938 to purchase FHA-insured mortgages
   b. Expanded to include VA-guaranteed mortgages in 1944

2. Secondary Market
   a. Rechartered in 1954 to be financed by private capital
   b. Empowered to sell as well as buy FHA and VA loans
   c. Purchase of mortgages
   d. Sale of mortgages through open-market transactions

3. Organization
   a. Reorganized under HUD Act of 1968 as fully private corporation, with government sponsorship
   b. Administered by Board of Directors with HUD approval on policies
   c. Ability to purchase at premium
   d. Emergency Home Finance Act of 1970

4. Administered Price System
   a. Free-market-system auction in the past
   b. Change to administered price system

5. Underwriting Standards
   a. Guidelines
   b. Conforming and nonconforming loans
   c. Electronic underwriting system

d. Credit scoring

6. Fannie Mae's Role in Housing Finance Today
   a. "Opening Doors to Affordable Housing"
   b. "Products for Untapped Markets"
   c. Community Home Buyer® Program

7. Affordable Housing Loans
   a. Flex 97
   b. www.homepath.com

8. Mortgage-backed securities (MBS)

B. Federal Home Loan Mortgage Corporation (Freddie Mac)

1. Organization
   a. Created under Emergency Home Finance Act of 1970 to provide secondary market for savings associations and thrifts
   b. Under direction of Federal Home Loan Bank Board
   c. Since 1989, independent stock company
   d. Governed by Board of Directors with HUD oversight as government sponsored enterprise (GSE)
   e. Office of Federal Housing Enterprises Oversight (OFHEO)

2. Operations
   a. Purchase conventional and government loans
   b. Collateralize as participation certificates (PCS)

3. Underwriting Standards
   a. Guidelines
   b. Electronic underwriting system
   c. Risk-based loan pricing

4. Affordable Housing Loans
   a. "Tools for Expanding Markets"
   b. Affordable Gold®
   c. Alt 97

C. Government National Mortgage Association (Ginnie Mae)

1. Organization
   a. Created under Urban Development Act of 1968 under direction of HUD
   b. Responsibilities

2. Mortgage-backed securities program
   a. Guaranteed payment for securities backed by government loans
   b. Types of programs

D. Other Government Participants

1. Federal Agricultural Mortgage Corporation (Farmer Mac)
    a. Created by Agricultural Credit Act of 1987
    b. Underwrites securities backed on pools of loans

2. Municipal Mortgage Enhancement (Munie Mae)

E. Real Estate Mortgage Investment Conduits (REMICS)

1. Tax Reform Act of 1986 provided REMICs
    a. Multiclass securities similar to earlier collateralized mortgage obligations (CMOs)
    b. Tranches

2. Applies to residential and commercial mortgage-backed securities

F. Secondary Market for Junior Financing Loans

1. Market for short-term, high-yield junior mortgages, deeds of trust, and contracts for deed
    a. Private lending companies originating junior loans, buy and sell existing second liens
    b. Real estate finance companies issuing junior loan based on equity for cash
    c. State licensing requirements

2. Land contracts and land promotion companies
    a. “retirement” or “second-home” communities
    b. Illegal activities

3. Fannie Mae and Freddie Mac participation

Chapter 5 SOURCES OF FUNDS

A. Commercial Banks

1. Fiduciary Responsibility
    a. Acts as agent on behalf of another person or organization (principal)
    b. Financial intermediaries—collect money from depositors and loan to borrowers
    c. Demand deposits—funds must be available to owners when called for (checking accounts)

2. Mortgage Loan Activities
    a. Business loans
    b. Interim financing
    c. Long-term mortgage loans
    d. Equity loans
    e. Trust department
    f. Originate and service loans for other lenders
    g. Real estate mortgage trusts (REMTs)

3. Financial Services Modernization Bill of 1999
    a. Eliminated many banking restrictions
    b. Prohibits banks from acting as real estate brokers

B. Mutual Savings Banks

1. Organization
    a. Originated in mid-19th century, mostly in eastern United States
    b. Mutual companies with depositor-owners receiving profits

2. Role
    a. Mainly local real estate financing activities
    b. Limited by charter

C. Savings Associations/Thrifts

1. Organization
    a. Originally building and loan associations
    b. Organized as stock or mutual companies

2. Federal Home Loan Bank System (FHLB) in 1932
    a. Parallels Federal Reserve System for commercial banks
    b. Created to regulate members, determine reserves and discount rates, and provide insurance for depositors
    c. Since FIRREA savings banks regulated by OTS, insurance provided by FDIC

3. Mortgage Lending Activities
    a. Have most flexibility in lending operations
    b. Participate in national mortgage market through Fannie Mae and Freddie Mac
    c. Current expansion

D. Life Insurance Companies

1. Second Largest Depository of Savings

2. Predominate Commercial Realty Loans

3. State Regulated

4. Concerned Primarily with Stability

5. Participation Financing

E. Pension and Retirement Programs

1. Pension Monies Collected from Payroll, Held in Trust Until Retirement

2. Historically, Invested in Government Securities and Corporate Stocks

3. Purchasing Mortgage-Backed Securities Today

F. Credit Unions

1. Created Under National Credit Union Administration (NCUA) in 1970
    a. Non-profit financial organizations
    b. Traditionally, made personal, home improvement, equity, or second mortgage loans

2. Credit Union Membership Access Act of 1999 Allows Expansion of Membership
    a. Competition to banking industry
    b. Expansion into mortgage loan financing

Chapter 6SOURCES OF FUNDS: SEMIFIDUCIARY AND NONFIDUCIARY

A. Semifiduciary Lenders

1. Mortgage Brokers and Bankers
    a. Mortgage brokers
    b. Mortgage bankers (or correspondents)

2. Real Estate Trusts
    a. Originated with Real Estate Investment Trust Act of 1960
    b. Qualifications for a trust
    c. Real estate investment trusts (REITs)
    d. Real estate mortgage trusts (REMTs)
    e. Combination (hybrid) trusts

3. Real Estate Bonds
    a. Finance real estate projects
    b. Nature of bonds
    c. Municipal and private bonds
    d. Zero coupon bonds
    e. Mortgage loan bonds

B. Nonfiduciary Lenders

1. Individuals
    a. Sellers
    b. Family members

2. Private Loan Companies
    a. Junior financing arrangements
    b. Loan from own funds, charge more

3. Foreign Funding Sources

Chapter 7INSTRUMENTS OF REAL ESTATE FINANCE

A. Encumbrances and Liens

1. Encumbrances
    a. Right or interest in a property by someone other than the owner
    b. Recorded covenants "run with the land"

2. Liens
    a. Financial encumbrance with property as security
    b. Deed of trust, mortgage, contract for deed
    c. Personal in quality

3. Mortgage Loan
    a. Specific, voluntary lien
    b. Recorded at courthouse where property located
    c. Lenders' rights superior to other lienholders
    d. "First in time, first in right" priority
    e. In event of foreclosure

B. Interests Secured by a Real Estate Loan

1. Interest in Real Property as Security for Real Estate Loan
    a. Fee simple ownership pledged as collateral
    b. Leasehold rights as collateral
    c. Other interests

2. Title, Lien, and Intermediate Theories
    a. Title theory
    b. Lien theory
    c. Intermediate theory

3. General Requirements for a Finance Instrument
    a. Contractual written agreement
    b. Basic instruments

C. Note and Deed of Trust (Trust Deed)

1. Trust
    a. Right of property held by one party for another
    b. Parties
    c. Trust as financing instrument: deed of trust

2. Note Used with Deed of Trust
    a. Note
    b. Deed of trust

D. Note and Mortgage

1. Note
    a. Complete contract
    b. Unsecured note
    c. Secured loan includes mortgage with note
    d. Provisions of a note

2. Mortgage
    a. Provisions vary depending on lender
    b. Standard components

E. Contract for Deed (Land Contract)

1. Various Forms
    a. Real estate contract, land contract, contract for sale, agreement for deed, installment sale, and articles of agreement
    b. No accompanying note
    c. Complete financing and sales agreement

2. Agreement Between Two Parties
    a. Vendee (buyer/borrower) and vendor (seller/lender)
    b. All conditions of sale included in contract
    c. In event of default
    d. Cautions and protections

F. Junior Finance Instruments

1. Junior Loans
    a. Can be deed of trust, mortgage or contract for deed
    b. Sources
    c. Uses
    d. Third mortgages or deeds of trust

2. Second Mortgage or Deed of Trust
    a. Lien on property second in position to first lien
    b. Clauses
    c. Interest rates
    d. Private mortgage insurance protection

G. Special Provisions in Mortgage Lending Instruments

1. Payment and Prepayment
    a. Late payment penalty
    b. Prepayment privilege
    c. Prepayment penalties
    d. Lock-in clause

2. Due-on-Sale and Assumption Clauses
    a. Lender permission for assumption
    b. Assumption versus subject to

3. Subordination Clause
    a. Lower priority position
    b. Sale of vacant land

4. Release Clause

5. Exculpatory Clause

6. Nonrecourse Clause

7. Extensions and Modifications
    a. Financially troubled borrower
    b. Problem with right of intervening lienor
    c. Lenders resist permanent alteration to loan

Chapter 8CONVENTIONAL LOANS

A. Interest Rates

1. Fixed-Rate Loan
    a. Amortized loans
    b. Term loans (interest only with balloon)
    c. 30-year mortgage
    d. 15-year mortgage

2. Adjustable-Rate Mortgage (ARM)
    a. Shared risk with lender
    b. Based on index
    c. Margin requirements
    d. Convertible ARMs
    e. Adjustment periods
    f. Lower initial rates

B. Private Mortgage Insurance (PMI)

1. Required on Conventional Loans
    a. Less than 20 percent down payment
    b. Payment

2. Home Owners Protection Act of 1998
    a. PMI automatically dropped with 22 percent equity
    b. Loans originated since July 29, 1999

3. Fannie Mae and Freddie Mac
    a. Reduced required insurance coverage
    b. Honoring Home Owners Protection Act on all existing mortgages in good standing upon borrower's request

4. Members of Mortgage Insurance Companies of America

5. PMI Companies Expanding
    a. Commercial and industrial mortgages
    b. Commercial Leasehold Insurance Corporation

C. Permanent/Temporary (Escrow) Buydown Plan

1. Lower Interest Rate and Payment in First Few Years

2. Permanent or Temporary Buydowns

D. Borrower's Qualifications

1. Fannie Mae and Freddie Mac Guidelines
   a. PITI not exceed 28 percent of gross income
   b. All above plus monthly debt not exceed 36 percent of monthly income
   c. Borrower have good credit
   d. Borrower have stable employment

2. Examples

E. Special Conventional Loan Programs

1. Community Home Buyer®
   a. Fannie Mae's first affordable loan product
   b. Five percent down payment

2. Affordable Gold®
   a. Freddie Mac's first affordable loan product
   b. Alt 97 (and Fannie's Flex 97) allow 3 percent down payment from any source

3. Zero Down Payment Mortgage
   a. Bank of America "Neighborhood Advantage Zero Down Mortgage"
   b. Insured by G.E. Capital Mortgage Insurance Corporation

4. Automatic Rate Reduction Loan
   a. Refinance at no cost to borrower at lower rate
   b. Borrower must have made timely payments and maintained credit worthiness

5. Subprime Loans
   a. B, C, and D paper
   b. Higher interest rates and fees

6. Track Record Adjusted Mortgage
   a. Reduces interest rate on subprime loans
   b. Rationale

7. Refinancing Existing Conventional Loans
   a. Costs of refinancing unregulated, vary greatly
   b. Determine total costs before decision to refinance

8. Electronic Real Estate Loan Services
   a. Non-regulated
   b. Web sites available

A. Organization and Requirements

1. FHA Under Direction of HUD with Ten Regional Locations

2. FHA Designates Lenders
   a. Provide long-term, amortizing loans
   b. Interest rates set by the market place
   c. Direct endorsement lenders

3. Requirements
   a. Careful review of loan application
   b. Comprehensive written appraisal
   c. Home inspection recommended
   d. Obvious property defects must be corrected

B. Program Summary

1. FHA Program of Mortgage Insurance
   a. In event of default, lender looks to FHA to recover balance of loan
   b. Reduced down-payment obstacle for cash-short buyers

2. Existing Programs (FHA-insured loans except where indicated as direct)
   a. Title I: home improvement loans
   b. Title II: Section 202—direct loans for housing for elderly or handicapped
   c. Section 203(b)—loans for single-family owner-occupied homes
   d. Section 203(k)—rehabilitation loans
   e. Section 203(v)—loans for eligible veterans
   f. Section 221(d)(2)—loans for low- to moderate-income families
   g. Section 221(d)(3)—insures 100% of loans for nonprofit sponsors to build multifamily rental housing for moderate income families
   h. Section 221(d)(4)—insures 90% of loans for profit sponsors to build rental housing for moderate income families
   i. Section 223(e)—loans in declining neighborhoods
   j. Section 223(f) —loans to purchase or refinance apartment buildings
   k. Section 231—loans for construction or rehab homes for elderly or handicapped
   l. Section 234—loans for construction or rehab of apartments to condominiums
   m. Section 245—graduated-payment loans
   n. Section 251—adjustable-rate loans

C. Underwriting Guidelines

1. Maximum Loan Limitations
   a. Set by geographic area
   b. Based on percentage of Fannie/Freddie limits

2. Down Payment Requirements
   a. Formula for calculating down payment and maximum loan
   b. Borrower must provide 3 percent of sales price: own funds, gift, or grant

3. Borrower's Income Qualifications
    a. Ratios
    b. 2.FHA use of Freddie Mac's Loan Prospector®

4. Mortgage Insurance Premium (MIP)
    a. Upfront MIP
    b. Annual renewal premium

5. Second Mortgages/Buydowns
    a. Conditions allowing second mortgages:
    b. Borrower qualifies at bought-down rate on buydown

6. Assumptions
    a. Prior to December 1989, generally assumable
    b. After December 1989, borrower must qualify

D. Other Frequently Used FHA Loans

1. Section 203(v): Veteran FHA loans
    a. eligible veterans who have used, or wish to save, VA entitlement
    b. does not affect VA entitlement

2. Section 245(a): Graduated-Payment Mortgage (GPM)
    a. Provides lower payments in first few years
    b. Creates negative amortization

3. FHA 251: One-year Adjustable-rate Mortgage (ARM)
    a. based on one-year T-bill index
    b. caps of one per year and five life-of-loan

4. FHA 203(k): Rehabilitation Home Loan
    a. Loans for purchase and rehabilitation of property
    b. Special features

E. Direct Endorsement and Coinsurance

1. Direct Endorsement Approved Lenders
    a. Underwrite loans
    b. FHA retains risk of default

2. Coinsurance
    a. Lender processes and underwrites loan
    b. Shares losses with FHA in case of default

F. Advantages of the FHA Mortgage

1. High Loan-to-Value (LTV)

2. Different types of Loans Available

3. No Due-on-Sale Clause, May Be Assumed

4. No Prepayment Penalty

G. Contributions to Real Estate

1. New Standards for Qualifying Borrowers

2. New Standards for Appraising Property

3. Long-Term Amortized Loan

4. Foundation for National Market in Mortgage Securities

Chapter 10 VA-GUARANTEED LOANS

A. U.S. Department of Veterans Affairs Real Estate Loan Guarantee Program

1. Former Veterans Administration, Supervises Many Programs

2. Serviceman's Readjustment Act, GI Bills of Rights
   a. Title III guarantees loans for eligible veterans
   b. Current guarantee is $50,750
   c. Expanded to include condominiums, cooperatives, and mobile homes

B. Program Application

1. Guarantees Loans (loans made by banks, thrifts, life insurance companies and mortgage brokers, and bankers)
   a. Lender compensated in case of default
   b. Managed by 55 regional offices
   c. Borrower must occupy property

2. Eligibility/Entitlement
   a. Based on active-duty criteria
   b. Some unremarried spouses of veterans
   c. Certificate of eligibility

3. Schedule of Guarantees
   a. VA guarantees top portion of loan balance
   b. Lender will lend four times amount of guarantee with no money down
   c. No limit on loan amount, only on amount of guarantee
   d. Partial entitlement

4. Certificate of Reasonable Value (CRV)
   a. VA requires appraiser to submit formal estimate of value of property that is valid for six months
   b. If CRV is less than sales price
   c. For purchase in excess of maximum loan (currently $203,000)

5. VA Loan Requirements
   a. Interest
   b. Income qualifying requirements
   c. Closing costs
   d. Funding fee

6. Miscellaneous
   a. Second mortgages allowed in certain conditions
   b. Buydowns allowed
   c. Assumptions
   d. Release of liability/novation
   e. Graduated-payment mortgage (GPM)

Chapter 11 PROCESSING REAL ESTATE LOANS

A. Qualifying the Borrower

1. Overview
   a. In the past
   b. Current
   c. Lenders under insured or guaranteed programs must follow guidelines to determine attitude as well as ability to pay

2. Loan Application
   a. Standardized loan application form
   b. Commercial or industrial application requires more information

3. Financial Statement
   a. Assets
   b. Liabilities
   c. Net worth: two to one ratio considered good risk

4. Data Verification
   a. Electronic underwriting systems
   b. Alternate documentation
   c. Deposits
   d. Employment
   e. Credit report

5. Credit Evaluation
   a. Quality of applicant's income evaluated
   b. Loan qualifying income ratios

B. Qualifying the Collateral

1. Definition of Value
   a. Value in use and value in exchange
   b. Market value

2. Staff or Fee Appraisers
    a. Large financial fiduciaries maintain staff appraisers
    b. Less active lenders and FHA hire fee appraisers

3. Appraisal
    a. Estimate of value at a given time
    b. Uniform Standards of Professional Appraisal Practice (USPAP)
    c. State licensed or certified appraisers
    d. Appraiser associations

4. The Appraisal Process
    a. Drive-by appraisals
    b. Full-blown appraisal process

5. Direct Sales Comparison Approach
    a. Market data approach
    b. Training and experience required

6. Cost Approach
    a. Based on current value of physical parts
    b. Best used for new or unique properties
    c. Rule of substitution
    d. Depreciation
    e. Cost approach formula

7. Income Capitalization Approach
    a. Value based on ability to generate income
    b. Capitalization rate: investors required rate of return
    c. Gross market income compared to comparable
    d. Deduction for operating expenses and reserves
    e. Net annual market rental income divided by cap rate

8. Gross Rent Multiplier (GRM)
    a. Estimate of value of single-family rental properties
    b. Divide recent sales by monthly market rent

9. Reconciliation of Data and Opinion of Value
    a. Written opinion may place more emphasis on one approach
    b. Weighted average technique

C. Qualifying the Title

1. Title Report
    a. Components
    b. Constructive notice: recorded items
    c. Actual notice: physical presence

2. Abstract and Opinion of Title
    a. Synopsis of current recorded condition of title
    b. Attorney indicates approval with written opinion

c. Abstract does not disclose hidden title hazards
d. No guarantee or insurance against defects

3. Title Insurance
   a. Insures quality of title to date, not in future
   b. Title companies combine abstracting with program of insurance
   c. American Land Title Association (ALTA) form

4. Torrens System
   a. Title search only back to previous search
   b. Torrens certificate issued from the state
   c. Cost of converting has inhibited adoption

5. Title Faults
   a. Cloud on the title
   b. File suit to quiet title

6. Surveys
   a. Lender may require
   b. Shows possible encroachments or easements

Chapter 12 CLOSING REAL ESTATE LOANS

A. Costs of Securing a Loan

1. Real Estate Settlement Procedures Act of 1974 (RESPA) Requirements
   a. Good faith estimate
   b. Truth-in-lending statement with APR

2. Points and Origination Fee
   a. Point is one percent of loan amount
   b. Discount points
   c. Origination fee

3. Impound Funds (Escrow Accounts)
   a. Monies collected monthly for payment of property taxes and insurance
   b. Lenders usually require two months left in escrow
   c. Property taxes

4. Insurance Premiums
   a. Hazard insurance
   b. Owner’s title insurance policy
   c. Mortgagee’s title insurance
   d. Mortgage insurance (charged by the lender)

5. Assessment Liens
   a. Off-site improvements
   b. Improvement district bonds

6. Interest Adjustments

a. Mortgage payments made in arrears
b. Regulation Z requires quote of APR

7. Prepayment Penalties
   a. Lender may charge if loan paid prior to normal time
   b. Jumbo ARMs often have penalty

8. Additional Charges and Requirements
   a. Brokerage Commission
   b. Transfer tax
   c. Credit report, appraisal, survey
   d. Attorney’s fee
   e. Escrow and recording fees
   f. Flood insurance

9. Prorations
   a. Allocate costs and credits
   b. Interest
   c. Property taxes
   d. Insurance (usually paid in advance)
   e. Additional prorations

10. Closing Statements
    a. Escrow officer prepares closing statement
    b. Parties are notified and documents signed and recorded
    c. Final settlement of funds
    d. HUD-1 settlement statement

B. Servicing the Loan

1. Servicing Responsibilities
   a. Principal and interest payments collected
   b. Taxes and insurance payment collected in escrow and paid out
   c. Borrowers informed how and where to make payment

2. Assignment of Loan
   a. Most loans sold (assigned) in secondary market
   b. Originator retains servicing for a fee
   c. Collection for late payments
   d. Borrower must be notified when loan is sold

Chapter 13 CONTEMPORARY REAL ESTATE FINANCE

A. Interest

1. Simple Interest
   a. Term loan (straight loan, bullet loan)
   b. Balloon payment of principal

2. Amortization

a. Regular payments over specified period
b. Distribution of principal and interest

B. Variations in Payments and Interest Rates

1. Fixed-Rate Mortgage
   a. Interest rate and repayment term do not change
   b. Impound or escrow funds may vary
   c. Payment applied first to interest, then principal

2. Graduated-Payment Mortgage (GPM)
   a. Lower payments in early years
   b. Negative amortization

3. Adjustable-Rate Mortgage (ARM)
   a. Adjustments periods
   b. Note rate
   c. Qualifying rate
   d. Index
   e. Margin
   f. Interest rate caps
   g. Payment caps
   h. Prepayment penalties
   i. Convertible loan
   j. Regulation Z disclosures

C. Innovative Payment Plans

1. Buydown Mortgage
   a. Lump-sum payment to lender when loan originated
   b. Stepped rate plan

2. 15-Year Mortgage
   a. Saves amount of interest paid
   b. Higher amount required for principal and interest

3. Reverse Annuity Mortgage (RAM)
   a. Capitalize on accumulated equity
   b. Benefit for elderly needing cash

4. Fannie Mae Senior Housing Opportunities Program
   a. Four different options
   b. Must qualify under usual requirements

5. Fannie Mae Two-Step Mortgage Plan
   a. Requires 10% down payment
   b. Lower interest rate for 7 years, adjusted based on 10-year Treasury bond with 6% cap

D. Variations in Formats

1. Open-End Mortgage
    a. Mortgage for future advances
    b. Allows borrower to borrow funds for personal property
    c. Utilizes by farmers and builders
    d. Legal problem with intervening liens
    e. Security agreements under Uniform Commercial Code

2. Construction Mortgage
    a. Unique form of open-end mortgage
    b. Application and requirements
    c. Pattern of disbursements
    d. Lender protection
    e. Sources of funds

3. Blanket Mortgage
    a. Covers more than one parcel
    b. Release clause
    c. Used for large tracts of land
    d. Recognition clause

4. Mortgage Participation
    a. Partnership of mortgagees
    b. Partnership of mortgagors
    c. Partnership of mortgages and mortgagors

5. Leasehold Mortgage
    a. Tenants pledge leasehold interest
    b. Credit loans

6. Package Mortgage
    a. Includes items of personal property
    b. Single financing agreement stretches payment over time

7. Mobile Home Mortgage
    a. Personal or real property?
    b. Manufactured housing units
    c. Mobile home loans usually 15 years
    d. Eligible for FHA and VA financing

8. Purchase-Money Mortgage
    a. Seller carries all or portion of sales price
    b. Senior or junior lien

9. Hard Money Mortgage (Equity Mortgage)
    a. Borrower receives "cash out"
    b. Equity in property pledged as collateral

10. Bridge Loan
    a. Short-term interest only loan

b. Used to bridge gap between selling one home and purchasing another

11. Wraparound Encumbrances (Wraps)
    a. Junior loan that encompasses existing debt
    b. Use has diminished since most loans cannot be assumed

E. Tax-free Mortgage Lending

1. Refinancing
    a. Securing new loan to replace old
    b. Income tax impact
    c. Balance possible gains against known costs

2. Installment Sales
    a. Postpone tax on capital gains on residential and commercial sales
    b. Computation of tax requires determination of installment factor (gain divided by equity)
    c. Advantageous to someone nearing retirement

3. Option to Buy
    a. Buyer has right (no obligation) to buy during option period
    b. Option payments not recognized as income until option is exercised or lapses
    c. Lease with option to buy

4. Exchanges
    a. Internal Revenue Code Section 1031 postpones recognition of gain
    b. Unlike property included in exchange is boot
    c. Mathematical equations involved in an exchange
    d. Three-party (Starker) exchanges more common

F. Sale-Leaseback

1. Used on Large Commercial Projects
    a. Frees up capital
    b. Fully net lease
    c. Seller/lessee benefits
    d. Advantages to investor/landlord

2. Sale-Leaseback-Buyback

G. Seller Options

1. Seller Refinances Prior to Sale
    a. Obtain mortgage that buyer can assume
    b. Seller refinances and accepts carryback wraparound contract for deed

2. Trading on Seller’s Equity
    a. Buyer refinances property instead of assuming mortgage
    b. Offsets risk with higher interest rate

H. Equity Participation

1. Sale-Buyback (Sale-Contract Back)
   a. Variation of sale-leaseback
   b. Purchase completed project and sell back on installment plan
   c. Lender retain legal title, includes kicker in payment
   d. Usually designed for 10 years beyond normal mortgage loan

2. Splitting Ownership
   a. Split-fee financing
   b. Lender benefits by receiving fixed return on investment
   c. Developer has advantage of high leverage and depreciable asset

3. Joint Ventures
   a. Most complete form of equity participation
   b. May include landowner, construction company, financier, and developer

Chapter 14 DEFAULTS AND FORECLOSURES

A. Defaults

1. Acceleration Clause
   a. Full amount of debt due upon default
   b. Lender may foreclose on collateral
   c. Workouts

2. Delinquencies
   a. Principal and interest
   b. Property taxes
   c. Other liens
   d. Hazard insurance
   e. Poor property management

B. Adjustments

1. Final Foreclosure Action
   a. Lender considers equity position and circumstances causing default
   b. Should only be considered when market value is less than balance owed and borrower can no longer make payments
   c. Deed in lieu of foreclosure
   d. Abandonment

2. Moratoriums and Recasting
   a. Forbearance or moratoriums
   b. Loans can be recast to lower payments
   c. Recasting requires new title search

3. Voluntary Conveyance of Deed
   a. Voluntary transfer of deed
   b. Deed in lieu of foreclosure

4. Housing Act of 1964
    a. FHA requires lenders provide relief where default is beyond borrower's control
    b. VA also requires leniency

C. Foreclosures

1. Foreclosure and Redemption Periods
    a. Equitable redemption period
    b. Strict forfeiture
    c. Statutory redemption period

2. Judicial Foreclosure and Sale
    a. Conventional mortgages
    b. Conventional insured mortgages
    c. FHA-insured mortgages
    d. VA-guaranteed mortgages
    e. Junior mortgages

3. Power-of-Sale Foreclosure
    a. Deeds of trust
    b. Mortgages

4. Strict Foreclosure
    a. Court establishes specific time for defaulted debt to be paid
    b. Lender may secure property with value in excess of loan balance
    c. Only surviving use is with contract for deed

5. Other Foreclosure Processes
    a. By advertisement
    b. By entry and possession
    c. By writ of entry

D. Deficiency Judgments

1. Lender Pursues Borrower for Losses
    a. Sues on note for deficiency judgment
    b. May be perfected against any property owned or acquired
    c. Deficiency judgments practically unenforceable
    d. With power-of-sale foreclosure, lender right to deficiency judgement restricted

2. Exculpatory Clause
    a. Limits personal liability
    b. Used on commercial real estate loans

3. No Deficiency Judgments Allowed by FHA; VA Frowns On

E. Tax Impacts of Foreclosure

1. Tax Due When Adjusted Book Value Less Than Balance of Loan

2. IRS Considers Gain

F. Auctions

1. Auction May Relieve Pressure of Carrying Costs Because Is Quicker

2. Carrying Costs Cannot Usually Be Recouped in Higher Sales Price